



Houlihan Lokey

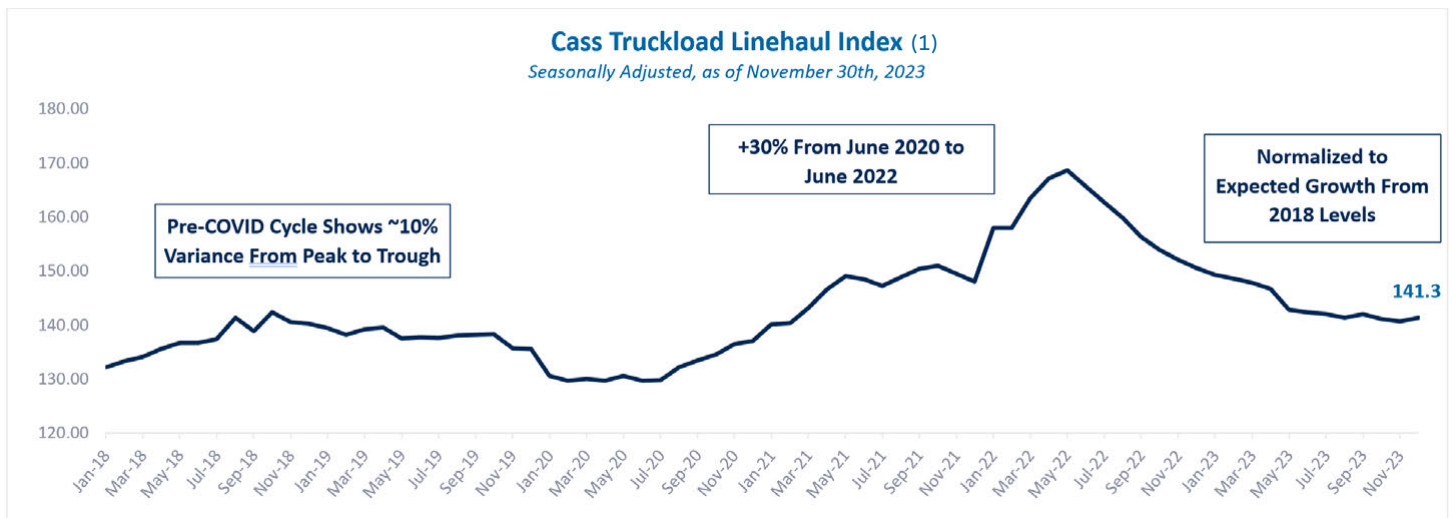
TRANSPORTATION AND LOGISTICS

Freight Brokerage: Lessons
From the Downturn and
Questions for the Next Cycle

Episode One

Introduction

Freight brokerage now approaches 50 years in development as an industry. Over that period, brokerage has experienced a long secular growth trend—ever “up and to the right” in the broad sweep—punctuated by periodic cyclical down drafts. Today, the industry sits in one of the sharpest troughs in memory, made all the more painful as it follows the crazy COVID highs of 2020 through 2022. As in earlier cycles, recent market inflection points have brought hyperbolic “this time is different” mentalities to the forefront—the outlook is perpetually sunny at the peak and forever cloudy in the trough. Neither perspective has borne out. Still, there is much to learn from a dispassionate review of the recent super cycle. Where was the market consensus off base? And what are the key questions going into the next cycle?



In this Market Digest series, we present thoughts in four parts:

- Episode One: The Agent Model
- Episode Two: Technology and Digital Freight Matching
- Episode Three: Contractual Versus Spot Freight
- Episode Four: Questions for the Next Cycle

Houlihan Lokey is an M&A market leader in the United States with dedicated coverage of the transportation and logistics (T&L) sector, giving us a unique vantage point into the ways our clients have successfully built enterprise value. Our experience leads us to believe the brokerage sector still offers compelling opportunities, especially for those looking to create value through a buy-and-build strategy.

Contact the Houlihan Lokey T&L investment banking team here to delve into more depth on any of these (or other) questions regarding the freight brokerage market.

⁽¹⁾ The Cass Truckload Linehaul Index reflects market fluctuations in per-mile dry van truckload pricing (spot and contract) in the U.S., isolating the linehaul component of full truckload costs from other components (e.g., fuel and accessorial) to illustrate trends in baseline truckload prices.

Episode One: The Agent Model

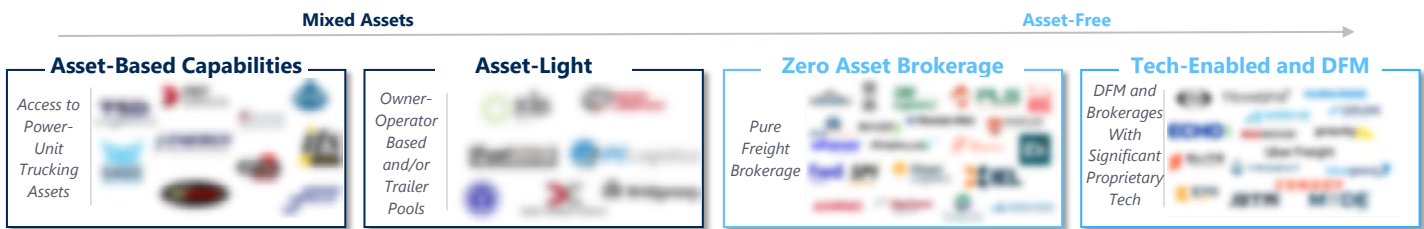
Market Snapshot

Freight brokers fall into two broad camps with respect to go-to-market labor models—agent or employee. Many companies stick entirely to one or the other model, while some blend both models in a single organization.

In the agent model, a brokerage (the “parent”) operates through a network of broker agents, analogous in some respects to franchisees of the parent (with important legal distinctions). The parent typically holds the shipper (customer) and carrier (supplier) relationships from a contractual legal perspective. The parent provides a transportation management system (TMS), an industry-specific enterprise operating system, and handles customer billing, carrier payment, insurance, safety and compliance, and other support services. Agents—who generally range in size from sole proprietorships to small-to-mid-sized companies—source and move the freight. Each agent secures required operating real estate and manages and pays its employees according to its own policies and practices. The parent and agents generally split gross margin dollars, customarily in the range of 20%–30% for the parent and 70%–80% for the agents.

In the employee or company-store model, individual freight brokers are W-2 employees of the freight broker. If the company maintains a network of offices, these are company-leased facilities. Fundamentally, from the company’s perspective, more of the cost structure is fixed, at least in the short-to-medium term.

Freight Brokerage Market Map



For full access to this chart, please contact the team on page 6.

Consensus View

While most rules have exceptions, both private equity investors and global logistics service providers generally favor employee-model brokers over agent-model brokers. Potential buyers see the agent model as inherently riskier. The broker parent may hold the legal customer and shipper relationships, but the agent manages those relationships on a day-to-day basis. Agents who leave—the thinking goes—could easily pull those customers away from the parent.

Contrarian Conclusion

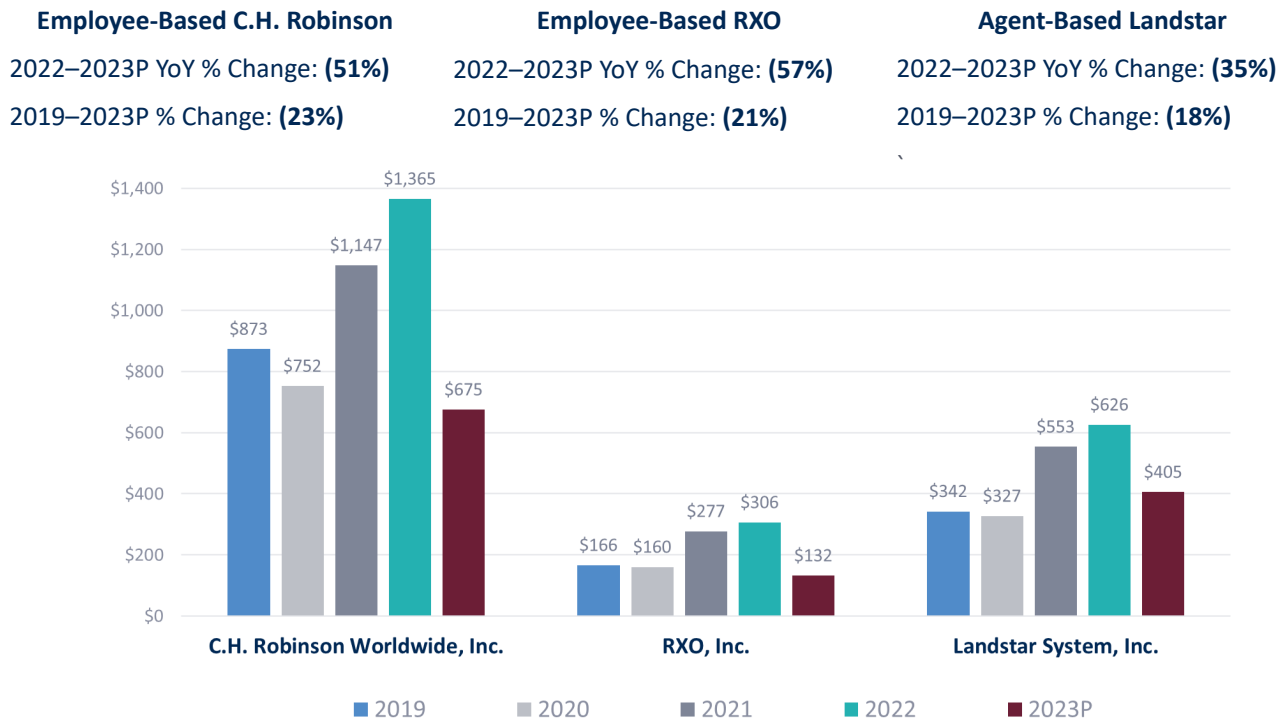
Past performance only tells us so much about future results. That said, in the recent cycle, agent-based freight brokers appear to have provided steadier financial results, perhaps less spiky on the upside and more sustainable in the softer part of the cycle.

Public market data—admittedly relatively sparse and anecdotal—supports this view. With TJC’s (formerly The Jordan Company) go-private acquisition of Echo Global Logistics, Inc., three scaled freight brokers trade in the public markets: C.H. Robinson Worldwide, Inc. (NASDAQ:CHRW), RXO, Inc. (NYSE:RXO), and Landstar System, Inc. (NASDAQ:LSTR).

A comparative view of EBITDA generation over time, presented in the chart on the next page, shows Landstar—a relatively pure-play agent brokerage model—off approximately 35% for 2023E (based on research analyst estimates) from the 2022 peak. Landstar shareholders certainly might rue the whipsaw down. However, broadening the aperture to exclude the black swan COVID years, Landstar’s 2023E performance is expected to be approximately 18% higher than the 2019 pre-COVID benchmark. By contrast, C.H. Robinson and RXO—relatively pure-play employee models—each are expected to be down more than 50% in 2023 when compared to 2022. Of note, this will place each company down approximately 20% against 2019 results as well.⁽²⁾

⁽²⁾ Source: Collective average of research analyst projections for Q4 2023.

Scaled Brokerage EBITDA Trends ⁽³⁾



This somewhat simplistic comparison of a few market participants illustrates but does not prove the point. Further support comes from our broader dialogue with dozens of privately owned brokerages. The same general pattern repeats. Virtually all freight brokers are seeing material declines from 2022 results. While this is a bit of an unfair comparison given the exceedingly unusual dynamics around COVID, charting differences in this whisper guidance, agent models consistently seem to have declined less severely than employee models.

Why might this pattern prevail? The explanation seems to be the natural and immediate cost variability inherent in the agent model. Much of the system-wide labor and real estate cost inside an agent network sits on agent profit and loss statements. If we had access to those agent P&Ls, we suspect they might show even steeper earnings declines than C.H. Robinson or RXO. This structural reality has a second-derivative impact on the culture of agency owners, who generally receive no fixed compensation. They wake up every day needing to move freight to cover costs and hopefully make money. This reality drives a hungrier, more aggressive approach to daily operations than one might see from employees compensated in part through fixed salaries.

Even if we assume agent models are more resilient in the short term, one might nonetheless favor the employee model for other reasons. Generally, the risk of material agent departures is a primary concern voiced by potential acquirers. In our view, practical realities suggest this consideration may be overblown. Meaningful agent departures are rare. Even so, a risk-averse investor imagines two potential scenarios for consideration:

Scenario One: An agency principal wishes to retire and, therefore, wants to sell his or her business.

Several impediments generally restrict an agent's ability to sell its business outside the parent company network, a reality we know well. Members of the Houlihan Lokey team successfully executed one of the few such sales. From a legal perspective, agency agreements typically contain restrictions on customer solicitation and may include a right to purchase the agency if the principal wishes to sell. Even if not part of the formal legal structure,

⁽³⁾ Source: S&P Capital IQ.

historical shipment data sits inside the parent's transportation management system, and the parent holds both accounts receivable and accounts payable for the business. Any buyer of an agency must get comfortable that the agent will be able to transfer the customer relationships, with the expectation that the parent might use its informational advantage to keep the customers. For these and other reasons, the vast majority of agency sale transactions are executed with the respective parent as the purchaser, typically at a relatively low earnings multiple.

Scenario Two: An agency principal may wish to leave the network and start a free-standing brokerage, hoping to capture more of the cash flow from operations.

Similar considerations make it difficult for an agent to leave a network and start a full-service brokerage. The agent's cash flow from past activity is tied up in receivables held by the parent, which might be at risk of delayed payment or forfeiture in a contested departure. In addition, a new brokerage is required to secure regulatory licensing from the federal government and adequate cargo and liability insurance. Each broker is assigned what is known as an "MC number" through this process. For liability reasons and to avoid fraudulent activities, many shippers have restrictions on moving freight with brokers who have newer MC numbers (which are sequentially issued) and insurance companies generally charge aggressive premiums for newer brokers. Even though an agent may have strong relationships with its customers, those shippers may refuse to move freight with that agent under a new legal structure.

As a final point on this topic, a few words about valuation are merited. While the consensus may be off base in some respects, it remains as the consensus for now, including with many logistics industry players who may otherwise be in the market to acquire broker capabilities. Absent proper positioning and muscular market education, agent models appeal to a narrower audience in the ordinary course. The result is that agent models sometimes trade at an unjustified discount to more readily accepted employee models, which can represent both opportunity and risk for potential acquirers.

Agent and Hybrid Agent Brokers to Watch

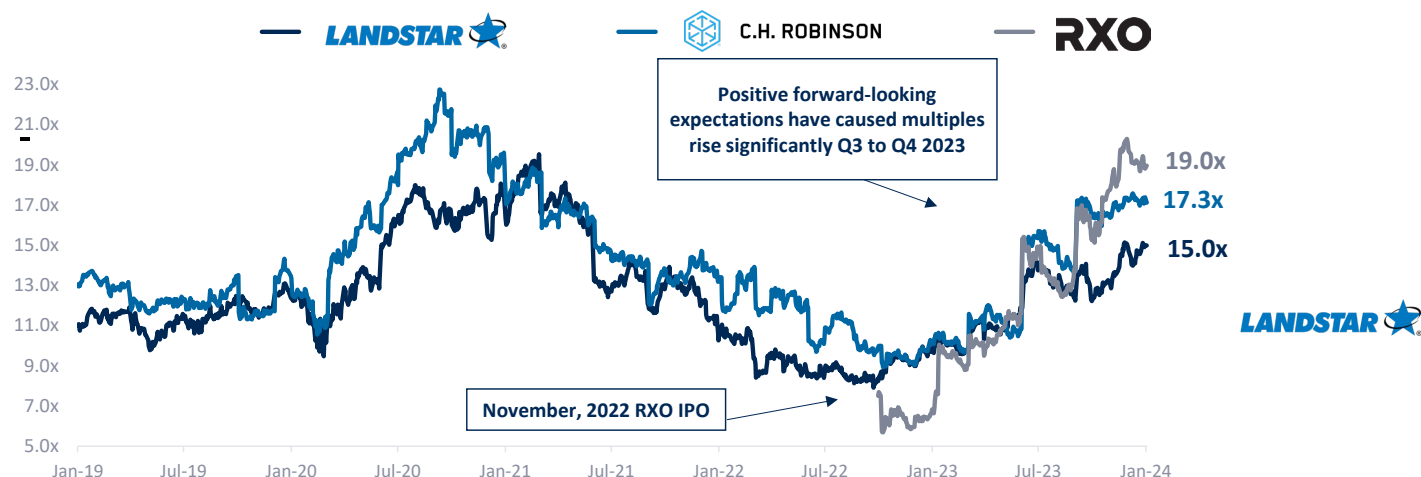
	Based in Charlotte, NC, Armstrong was named a top 20 U.S. brokerage firm by Transport Topics in 2023 and is a non-asset based, hybrid agent-and-employee freight brokerage. The company has a tech-forward culture through its proprietary TMS platform and is led by a CEO with significant technology leadership experience. Carousel Capital acquired the business in June 2019.
	Bridgeway is a top 50 transportation and logistics company that operates a hybrid agent and W2-based model with differentiated asset-light capacity solutions of dedicated owner-operators and brokerage. The company focuses on full truckload specialized freight in such end-markets as manufacturing, government, power generation and industrials with a unique capability in open deck and flatbed transportation. Based near Pittsburgh, Pennsylvania, Bridgeway was acquired by Gemspring Capital in May 2021.
	Logistic Dynamics is a leading agent-based, non-asset freight brokerage and leverages its newly upgraded, proprietary TMS platform to service its agents, shippers, and carrier partners. Originally focused on truckload freight, the company has aggressively expanded its intermodal and LTL footprint. Tritium Partners purchased the company in 2020. The business is based in Buffalo, New York.
	MODE Global is a top 10 freight brokerage in the U.S. with a highly unique, proprietary technology offering and is the No. 1 non-asset intermodal carrier in the country. Based in Dallas, Texas, MODE operates a hybrid agent-based and W-2 employee model. The company has been backed by York Capital since August 2018.

Public Brokerage Financial Statistics⁽⁴⁾

Company Name	\$ in U.S. Millions		Total					LTM			TEV		
	Equity Value	Enterprise Value	Enterprise		LTM		EBITDA		Net Debt	Net Debt / LTM EBITDA	LTM EBITDA	NFY EBITDA	
			Revenue	Margin	Revenue	Margin	EBITDA	Margin					
C.H. Robinson Worldwide, Inc.	\$ 10,013	\$ 11,791	\$ 18,441	6.8%	\$ 689	3.7%	\$ 1,777	2.6x	17.1x	14.0x			
RXO, Inc.	\$ 2,602	\$ 3,127	\$ 4,069	18.8%	\$ 165	4.1%	\$ 525	3.2x	19.0x	13.5x			
Landstar System, Inc.	\$ 7,079	\$ 6,708	\$ 5,699	21.3%	\$ 448	7.9%	\$ (372)	N/M	15.0x	14.5x			
Mean			\$ 9,403	15.7%	\$ 434	5.2%	\$ 644	2.9x	17.0x	14.0x			
Median			\$ 5,699	18.8%	\$ 448	4.1%	\$ 525	2.9x	17.1x	14.0x			

⁽⁴⁾ S&P Capital IQ figures as of 01/29/2024 market close; LTM figures through Q3 2023.

Public Brokerage Historical TEV/LTM EBITDA⁽⁵⁾



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Featured Transactions

 a joint-venture between has acquired Buy-side Advisor	 has been acquired by a portfolio company of Sell-side Advisor	 has been acquired by a portfolio company of Sell-side Advisor	 has been acquired by Sell-side Advisor	 a portfolio company of has been acquired by and Sell-side Advisor	 has received a majority investment from and Sell-side Advisor
 has been acquired by Sell-side Advisor	 a portfolio company of has completed a recapitalization and acquired Intermodal & Drayage Division Fairness Opinion	 Worldwide Flight Services a portfolio company of €125,000,000 Senior Secured Bridge Facility Acquisition Financing Exclusive Placement Agent	 has been acquired by Sell-side Advisor	 Term Loan & Delayed Draw Term Loan Refinancing & Growth Financing \$85,000,000 Exclusive Placement Agent	 a portfolio company of Dividend Recapitalization & Acquisition Financing Revolver & Term Loan Exclusive Placement Agent

Tombstones included herein represent transactions closed from 2020 forward.

⁽⁵⁾ S&P Capital IQ figures as of 01/29/2024 market close; LTM figures through Q3 2023.

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